IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. ~~1249~~ 94

MOTHER LODE COALITION MINES COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The petitioner prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered in the above-entitled case on February 21, 1942 (R. 90).

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 15) is reported at 42 B.T.A. 596. The opinion of the Circuit Court of Appeals (R. 85) is reported at 125 F.(2) 657.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 21, 1942 (R. 90). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the petitioner is entitled under Section 114(b)(4) of the Revenue Act of 1934 to take a deduction for percentage depletion in its 1935 return.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra*, pp. 9-12.

STATEMENT

The petitioner, a corporation organized under the laws of the State of Delaware, acquired a copper mining property in Alaska in 1919, and for many years thereafter engaged in the business of mining and selling copper (R. 11-12). Prior to the Revenue Act of 1932, the depletion allowance for metal mines had been computed on the basis of cost or discovery value. Section 114(b)(4) of that Act, *infra*, p. 9, introduced a new method of computation—percentage depletion. In the case of metal mines, it provided an allowance for depletion of fifteen percent of the gross income from the property, if such allowance did not exceed fifty percent of the net income of the taxpayer computed without allowance for depletion. The section further provided that the taxpayer should state in the 1933 return whether he elected to have the depletion allowance for the succeeding taxable years computed with or without reference to percentage depletion. In

its income tax return for 1933, the petitioner, which had exhausted cost depletion (R. 12, 47), naturally made an election of depletion "on the percentage basis for the year 1933 and thereafter" (R. 13).

The provisions of the 1932 Act were re-enacted, with slight modifications, in Section 114(b)(4) of the Revenue Act of 1934, *infra*, p. 10. This Section, which granted the same allowance for depletion, continued as follows:

> "A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion."

During the year 1934, the petitioner stopped mining operations and shut down its mine, although it sold some copper which had been mined in prior years (R. 12). Its return for that year showed a net loss of $38,898.26 (R. 13, 45, 49). The treasurer of the petitioner, who prepared that return, believed that it was not entitled to any deduction for depletion because it had no net income in 1934 and it could have, therefore, no depletion allowance (R. 14, 45). Moreover, he considered the election made in the 1933 return and concluded that petitioner had made a binding election for succeeding years (R. 14, 45). Consequently, no reference whatever was made to depletion in the 1934 re-

turn (R. 14). The respondent made no adjustments in petitioner's 1934 return.

In 1935 the petitioner resumed mining operations, and its return for that year showed a net income of $63,466.00. In its return the petitioner claimed a deduction of $25,276.88 for percentage depletion (R. 11-12). The return contained the following statement (R. 12):

> "Under the provisions of Section 114 (b) (4) of the Revenue Act of 1932, the taxpayer elected to deduct depletion on the percentage basis for the year 1933 and thereafter."

The 1935 return was reviewed, and a report made by the Internal Revenue Agent dated December 31, 1936, which made no change in the petitioner's deduction for percentage depletion (R. 67-73). More than two years later, a second Agent's report disallowed the deduction (R. 14, 76), and the Commissioner thereupon determined a deficiency in the amount of $3,475.57 (R. 6-7). The Board of Tax Appeals sustained that determination (R. 20). The Circuit Court of Appeals for the Second Circuit affirmed (R. 90):

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that under Section 114(b)(4) of the Revenue Act of 1934 the petitioner was required to state its election of percentage depletion in the 1934 return.

2. In failing to hold that petitioner's election of percentage depletion for 1933 and thereafter constituted a valid election under Section 114(b)(4) of the Revenue Act of 1934.

3. In failing to hold that petitioner's original return for 1935 was the "first return" under the Revenue Act of 1934 within the definition of Section 114(b)(4) of that Act.

4. In holding that petitioner was not entitled to a deduction for percentage depletion for the year 1935.

5. In affirming the order of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

By the provisions of Section 114(b)(4) of the Revenue Act of 1932, taxpayers were allowed to elect percentage depletion upon the condition that depletion "for all succeeding taxable years shall be computed according to the election thus made". Pursuant to that section, the petitioner made that election "for 1933 and thereafter." In 1934, when the property showed a net loss, not only was there no occasion for a mention of depletion, but the petitioner's officers believed that the election they had made the year before was still binding. On these facts, the petitioner has urged, before both the Board of Tax Appeals and the court below, that its election under the 1932 Act was effective under the 1934 Act, and, alternatively, that if a fresh election were necessary under the 1934 Act, the 1935 return, which elected percentage depletion, was the "first return" under the 1934 Act. Both of these contentions were rejected by the Board and the court below, although the Board has since changed its opinion on the latter. *Tonopah Mining Co.* v. *Commissioner*, 44 B. T. A. 165, 168, *aff'd.*, C. C. A. 3, March 17, 1942, C. C. H. Fed. Tax Serv. (1942) ¶ 9351. We submit that the decision below should be reviewed by this Court for several reasons.

1. The decision below is in direct conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *Pittston-Duryea Coal Co.* v. *Commissioner*, 117 F. (2d) 436. In that case the court held that under the Revenue Act of 1934, the taxpayer was not required to state its election of percentage depletion in its 1934 return when that return showed a net loss without any allowance for depletion. This conflict is expressly noted by the court below (R. 90):

> "This view is not the one adopted by the Third Circuit in *Pittston-Duryea Coal Co.* v. *Commissioner*, 117 F. 2d 436. That opinion, however, does not discuss the phrase 'first return in respect of a property' nor Article 23(m)5 of Treasury Regulations 86. For the reasons already stated we must with all deference decline to follow it."

The Circuit Court of Appeals for the Third Circuit has acknowledged the conflict in *Tonopah Mining Co.* v. *Commissioner, supra*, in which it cited the *Pittston-Duryea* case, saying (ftn. 6):

> "The Second Circuit Court of Appeals has held, contra, criticising our decision. *Mother Lode Coalition Mines Co.* v. *Comm'r.*, 1942, 4 C. C. H., Para. 9264."

2. The decision of the Circuit Court of Appeals that the petitioner was required under the 1934 Act, to make a fresh election, gave no weight to the unmistakable Congressional intent. The legislative history of the 1934 Act shows conclusively that Congress did not intend to require a fresh declaration from taxpayers who had already made an election to take percentage depletion under the 1932 Act but rather that it was merely giving a fresh opportunity to make such a declaration. The taxpayer was not to be compelled to make a new

election, but was to be "entitled" or "permitted" to do so. (H. Rep. 704, 73d Cong., 2d Sess., p. 29, S. Rep. 558, 73d Cong., 2d Sess., p. 36). See also 78 Cong. Rec. 2922.

The lower court predicated its decision upon the assumption that the statutory language was unambiguous and mandatory. But the words "shall state" are not necessarily imperative. "The context and the expressive intention of the writer may, of course, often set aside the application of the grammarians' rules" to the effect that "shall", when used in the third person, is expressive of some authority or compulsion on the speaker's part. WEBSTER'S NEW INTERNATIONAL DICTIONARY (2d Ed. Unabridged), p. 2300. See *Escoe* v. *Zerbst*, 295 U. S. 490, 493; *cf. West Wisconsin Railway Co.* v. *Foley*, 94 U. S. 100, 103; *Richbourg Motor Co.* v. *United States*, 281 U. S. 528, 534. In short, the statute is ambiguous on its face, and only by recourse to the expressed intention of Congress could it be determined whether "shall state" conveyed permission or command. The error of the court below in disregarding the clear expressions of legislative intent not only departed from the well-established decisions of this Court, *Wright* v. *Vinton Branch*, 300 U. S. 440, 463, and cases cited, but also creates an erroneous gloss upon an important Federal statute. On both grounds the error should be corrected by this Court.

3. Moreover, not merely similar, but the precise questions at issue are of continuing importance in the tax statutes. The language of Section 114(b)(4) of the 1934 Act was re-enacted in the Revenue Acts of 1936 and 1938. 49 Stat. 1686-87; 52 Stat. 495-96. In addition, the later statutes provide that "for the purpose of determining whether the method of computing the de-

pletion allowance follows the property", they shall be considered a continuation of Section 114(b)(4) of the 1934 Act and as giving no new election in cases where that section "would, if applied, give no new election". *Cf. Tonopah Mining Co.* v. *Commissioner,* C. C. A. 3, March 17, 1942, C. C. H. Fed. Tax Serv. (1942) ¶ 9351.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition should be granted.

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May, 1942

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169.

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(b) Basis for Depletion—

(4) *Percentage Depletion for Coal and Metal Mines and Sulphur.*—The allowance for depletion shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance for the taxable year 1932 or 1933 be less than it would be if computed without reference to this paragraph. A taxpayer making return for the taxable year 1933 shall state in such return, as to each property (or, if he first makes return in respect of a property for any taxable year after the taxable year 1933, then in such first return), whether he elects to have the depletion allowance for such property for succeeding taxable years computed with or without reference to percentage depletion. The depletion allowance in respect of such property for all succeeding taxable years shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for succeeding taxable years shall be computed without reference to percentage depletion.

* * *

Regulations 77, promulgated under the Revenue Act of 1932:

ART. 225. Computation of depletion based on a percentage of income in the case of coal mines, metal mines, and sulphur mines or deposits.—

* * *

In the return for the taxable year 1933 the taxpayer must state as to each property whether he elects to have the depletion allowance for each property for 1934 and succeeding

taxable years computed with or without reference to percentage depletion.—In the case of any property in respect of which a return is first made by the taxpayer in a year subsequent to 1933, the taxpayer must state as to each property whether he elects to have the depletion allowance for succeeding taxable years computed with or without reference to percentage depletion. An election once exercised under section 114(b)(4) and this article can not thereafter be changed by the taxpayer, and the depletion allowance in respect of each such property will for all succeeding taxable years be computed in accordance with the election so made. If the taxpayer fails to make such statement in the return in which the election should be so indicated, the depletion allowance for the year for which an election must be first exercised and for all succeeding taxable years will be computed without reference to percentage depletion.

* * *

Revenue Act of 1934, c. 277, 48 Stat. 680.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(b) Basis for Depletion.—

(4) *Percentage Depletion for Coal and Metal Mines and Sulphur.*—The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for

depletion) from the property. A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. The method, determined as above, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer, or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer, either directly or through one or more substituted bases, as defined in that section.

Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23(m)-5. Computation of depletion based on a percentage of income in the case of coal mines, metal mines, and sulphur mines or deposits.—Under section 114(b)(4) a taxpayer may deduct for depletion an amount equal to 5 per cent of the gross income from the property during the taxable year in the case of coal mines, an amount equal to 15 per cent of the gross income from the property during the taxable year in the case of metal mines, and an amount equal to 23 per cent of the gross income from the property during the taxable year in the case of sulphur mines or deposits, but such deduction shall not in any case exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. (For definitions of "gross income from the property" and "net income of the taxpayer (computed without allowance for depletion) from the property," see article 23(m)-1 (g) and (h).)

In his first return made under Title I of the Act (for a taxable year beginning after December 31, 1933) the taxpayer must state as to each property with respect to which the taxpayer has any item of income or deduction whether he elects to have the depletion allowance for each such property for the taxable year computed with or without refer-

ence to percentage depletion. An election once exercised under section 114 (b)(4) and this article can not thereafter be changed by the taxpayer, and the depletion allowance in respect of each such property will for all succeeding taxable years be computed in accordance with the election so made. If the taxpayer fails to make such statement in the return in which the election should be so indicated, the depletion allowance for the year for which an election must be first exercised and for all succeeding taxable years will be computed without reference to percentage depletion. The method, determined under section 114(b)(4) and this article, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer, or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer, either directly or through one or more substituted bases, as defined in that section.